

Informed Policies to Combat Money Laundering

Submitted to:

William Baity, Acting Director
Financial Crimes Enforcement Network
United States Department of the Treasury



Prepared by:

Matthew Bruhn

Candidate for Master in Public Policy
in Business and Government Policy
John F. Kennedy School of Government
Harvard University

Advisor: Professor Malcolm Sparrow
Seminar Leaders: Professors Jay Siegel and Jack Donohue

April 7, 1998

DISTRIBUTION STATEMENT A

Approved for public release:
Distribution Unlimited

DTIC QUALITY INSPECTED 4

19981119 019

Informed Policies to Combat Money Laundering

Submitted to:

The Financial Crimes Enforcement Network

United States Department of the Treasury

by

Matthew A. Bruhn

Candidate for Masters in Public Policy in Business & Government Policy

John F. Kennedy School of Government, Harvard University

The U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) is tasked with establishing, overseeing, and implementing laws to prevent and detect money laundering. FinCEN is best able to help others combat money laundering by emphasizing its role as a provider of strategic intelligence and analysis. To provide valuable intelligence and analysis, however, FinCEN must possess a complete understanding of money laundering. This Policy Analysis Exercise broadens FinCEN's understanding and provides policy recommendations stemming from three key questions.

1. Is "good" information available on the costs and magnitudes of money laundering?
2. Does increasing the price of laundering reduce crime?
3. What will be the impact of future technology on FinCEN's ability to help combat laundering?

Key recommendations from the analysis include that FinCEN should:

1. Dedicate resources to collect, analyze, and distribute information on the costs and magnitudes of money laundering. FinCEN should also emphasize non-drug related crime and individual costs of laundering activities.
2. Examine the use of Geographic Targeting Orders (GTOs), and other methods of displacement, to collect better information on the magnitudes of money laundering.
3. Create and distribute to law enforcement agencies information on:
 - a. Suggested displacement methods for invalidating laundering organizations.
 - b. How displacement increases the vulnerability of criminals.
 - c. Why coordination among law enforcement is critical for detecting displacement.
 - d. Where displaced organizations and cash move and how they can be detected.
4. Develop methods of facilitating coordination among law enforcement agencies so that they are prepared when laundering organizations and their illicit proceeds are displaced.
5. Dedicate resources to study:
 - a. New payment systems and how regulation and law enforcement must adapt; and
 - b. Potential new technologies for combating money laundering, including methods to detect the bulk shipment of cash.

REPORT DOCUMENTATION PAGE			Form Approved OMB No. 0704-0188	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188), Washington, DC 20503.				
1. AGENCY USE ONLY (Leave blank)		2. REPORT DATE 14.Oct.98		3. REPORT TYPE AND DATES COVERED MAJOR REPORT
4. TITLE AND SUBTITLE INFORMED POLICIES TO COMBAT MONEY LAUNDERING				5. FUNDING NUMBERS
6. AUTHOR(S) 2D LT BRUHN MATTHEW A				
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) HARVARD UNIVERSITY				8. PERFORMING ORGANIZATION REPORT NUMBER
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES) THE DEPARTMENT OF THE AIR FORCE AFIT/CIA, BLDG 125 2950 P STREET WPAFB OH 45433				10. SPONSORING/MONITORING AGENCY REPORT NUMBER 98-023
11. SUPPLEMENTARY NOTES				
12a. DISTRIBUTION AVAILABILITY STATEMENT Unlimited distribution In Accordance With AFI 35-205/AFIT Sup 1				12b. DISTRIBUTION CODE
13. ABSTRACT (Maximum 200 words)				
14. SUBJECT TERMS				15. NUMBER OF PAGES
				16. PRICE CODE
17. SECURITY CLASSIFICATION OF REPORT	18. SECURITY CLASSIFICATION OF THIS PAGE	19. SECURITY CLASSIFICATION OF ABSTRACT	20. LIMITATION OF ABSTRACT	

Acknowledgements

The author would like to express his gratitude to the Financial Crimes Enforcement Network and to the following individuals who provided their time and expertise to this endeavor.

Stanley Morris	William Baity	Dave Gilles
Sandra Peaks	Ed Doyle	Mike Orndorff
Mike Rosenberg	Tom Ryder	Charles Klingman
Tom Kleiner	Cordell Hart	Greg Passic
John Cassara	Germaine Perambo	Lara Shafer
Jeff Shafer	Arnetta Cain	Steve Rudzinski
Malcolm Sparrow	Jay Siegel	Richard Poll

Outline

I. Executive Summary	iv
II. Introduction	1
A. The Financial Crimes Enforcement Network (FinCEN)	1
B. Purpose	3
C. Methodology	3
D. Guiding Values	3
III. Problem Definition—FinCEN's Three Questions	5
A. Is Good Information Available on the Costs and Magnitudes of Money Laundering?	
B. Does Increasing the Price of Laundering Directly Reduce Crime?	
C. What Will Be the Impact of Future Technology on FinCEN's Ability to Help Combat Money Laundering?	
IV. Background	6
A. History of Money Laundering	6
B. What is Money Laundering?	6
C. Who are the Money Launderers?	8
D. Why is Money Laundering Bad?	8
E. Why is Laundering Especially Attractive to Law Enforcement?	9
V. Development & Analysis of Questions	11
A. Is Good Information Available on the Costs and Magnitudes of Money Laundering?	11
B. Does Increasing the Price of Laundering Directly Reduce Crime?	19
C. What Will Be the Impact of Future Technology on FinCEN's Ability to Help Combat Money Laundering?	28
VI. Recommendations	34
VII. Provisions for Monitoring Outcomes	36
VIII. Conclusion	37
IX. Bibliography	38
X. Works Consulted	40

I. Executive Summary

The U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) is tasked with establishing, overseeing, and implementing laws to prevent and detect money laundering. With its limited resources, FinCEN is dwarfed by the magnitude and dynamic complexity of the problem. Therefore, to be effective, it must help others place their time, effort, and money where they have the largest impact. FinCEN is best able to help others combat money laundering by emphasizing its role as a provider of strategic intelligence and analysis. To provide valuable intelligence and analysis, however, FinCEN must possess a complete understanding of money laundering. This Policy Analysis Exercise broadens FinCEN's understanding and provides policy recommendations stemming from three key questions.

Is "good"¹ information available on the costs and magnitudes of money laundering?

Good information on the costs and magnitudes of laundering is not available. While estimates of the total cost of laundering may be accurate, they do not disaggregate individual costs, which would help identify critical steps for targeting by law enforcement. Estimates of the magnitude of money laundering are extremely unreliable. This is because the methods employed suffer from technical problems, lack of resources, and guesswork. Furthermore, estimates of both the costs and magnitudes fail to account for non-drug related crime—a large source of illicit proceeds.

Does increasing the price of laundering reduce crime?

Increasing the price of laundering services, alone, does not reduce crime. This is because the criminal's need for secrecy, with respect to their cash flows, is inelastic—

they demand secrecy at nearly any cost. Secrecy is provided to the criminal by laundering their money. As the price of money laundering increases the criminal will gladly pay for it without reducing their demand (the amount of crime they commit) as they must have secrecy to remain in business and out of jail.

If the price of laundering were to exceed the criminal's revenue we would see an end to profit motivated crime. Unfortunately, most criminals' profits are so large that they will continue to commit crime far beyond the laundering price which law enforcement methods might realistically cause. Thus, using the price of laundering services to deter crime is ineffective.

Rather than aiming to increase the price of money laundering, law enforcement should seek to displace the suppliers of laundering services and their cash flows by targeting their organizations and transfer methods. This "displacement" increases the vulnerabilities and risks of criminals by forcing them to develop new laundering methods or return to old methods. In each case, if law enforcement is prepared to detect the displacement it can increase seizures and convictions and thus reduce crime.

Additionally, monitoring the displacement of laundering organizations and their transportation methods provides valuable information about the magnitudes and routes of money laundering—information that can help identify further laundering and crime.

What will be the impact of future technology on FinCEN's ability to help combat laundering?

New technologies present both challenges and opportunities for FinCEN and law enforcement. While new payment systems, such as cyber-currency and stored-value cards, challenge traditional law enforcement techniques, new technologies for the

¹ For the purposes of this analysis, "good" information refers to information that is valid and complete.

detection of money laundering may give FinCEN the ability to monitor transactions with much greater scrutiny. The result of these opposing developments is unknown.

However, one thing is certain—to remain capable of helping law enforcement to combat money laundering, FinCEN must keep apprised of new technologies with implications for money laundering.

Recommendations—The Financial Crimes Enforcement Network:

The resulting policy recommendations describe how FinCEN should proceed to help law enforcement maximize their impact in the deterrence of money laundering.

FinCEN should:

1. Dedicate resources to collect, analyze, and distribute information on the costs and magnitudes of money laundering. FinCEN should also emphasize non-drug related crime and individual costs of laundering activities.
2. Examine the use of Geographic Targeting Orders (GTOs), and other methods of displacement, to collect better information on the magnitudes of money laundering.
3. Create and distribute to law enforcement agencies information on:
 - a. Suggested displacement methods for invalidating laundering organizations.
 - b. How displacement increases the vulnerability of criminals.
 - c. Why coordination among law enforcement is critical for detecting displacement.
 - d. Where displaced organizations and cash move and how they can be detected.
4. Develop methods of facilitating coordination among law enforcement agencies so that they are prepared when laundering organizations and their illicit proceeds are displaced.
5. Dedicate resources to study:
 - a. New payment systems and how regulation and law enforcement must adapt; and
 - b. Potential new technologies for combating money laundering, including methods to detect the bulk shipment of cash.

If FinCEN is able to act on these recommendations it will dramatically increase its ability to aid law enforcement and combat money laundering.

II. Introduction

Whoever stated that "crime doesn't pay," surely was not referring to its financial gain. The reality is that crime pays, and it pays well! Indeed, financial gain is the main motivation of most organized criminal endeavors.² Despite the important connection between financial gain and crime, law enforcement officers find it difficult to track the flow of illicit proceeds. This is because financial investigations are often complex and require special expertise. Criminal organizations potentially remain one step ahead of investigators by exploiting the complexity, high volume, and rapid pace of transactions as well as the lack of coordination and financial expertise among law enforcement agencies.

A. The Financial Crimes Enforcement Network

Because of these problems, in 1990 the U.S. Department of the Treasury designated the Financial Crimes Enforcement Network (FinCEN) as "one of the primary agencies to establish, oversee, and implement policies to prevent and detect money laundering."³ FinCEN is directed to support foreign, federal, state, and local law enforcement agencies in conducting investigations involving criminal proceeds.

FinCEN seeks to accomplish these objectives in several ways. First, FinCEN uses counter-money laundering laws (such as the Bank Secrecy Act--"BSA") to require reporting and record keeping by banks and other financial institutions. This record keeping preserves a financial trail for investigators to follow as they track criminals and their assets. In addition, FinCEN provides intelligence and analytical support to more

² Although crimes of passion receive much attention, their numbers are dwarfed by profit motivated crime according to: Hart, Cordell. "Money and 'Guanxi': Keys to Understanding Crime by Asians." US Department of the Treasury: FinCEN. Washington, DC. March 8, 1996. Pg. 3.

than 150 federal, state, and local law enforcement agencies that combat money laundering.⁴ In this capacity, FinCEN "...assists the law enforcement and intelligence communities by studying financial crimes and money laundering with a focus on the 'big picture' as well as the future."⁵ FinCEN analysts also develop expertise and knowledge in certain financial service areas such as wire transfers and free trade zones.⁶ It is important to note that FinCEN is not a traditional arm of law enforcement in that it does not participate in arrests or convictions.

Located just outside of our nation's capitol in Vienna, Virginia, FinCEN has a budget of approximately \$23 Million. It employs approximately 180 full time personnel, including intelligence analysts, finance and computer experts, and criminal investigators.⁷ Forty long-term detailees from 21 regulatory and law enforcement agencies are also assigned to FinCEN.⁸

FinCEN's analysts analyze information reported under the Bank Secrecy Act combined with information made available from other government and commercial systems. "Using advanced technology, FinCEN links together the various financial elements of crime; helping federal, state, and local law enforcement find the missing pieces to the criminal puzzle."⁹ FinCEN provides this information to its customers in the

³ "FinCEN's Frequently Asked Questions: How has the Treasury Addressed the Problem?" US Department of the Treasury: FinCEN. **Error! Bookmark not defined.** /fincen/faqs.html/#problem.

⁴ "FinCEN's Frequently Asked Questions: Who are FinCEN's Customers." US Department of the Treasury: FinCEN. **Error! Bookmark not defined.** /fincen/faqs.html/#problem.

⁵ Mike Rosenberg, FinCEN Analyst.

⁶ Ibid.

⁷ 1998 Appropriated funds: \$22.825 Million; Crime Bill: \$1 Million; High Intensity Drug Trafficking Area: \$67 Thousand. FinCEN is authorized 181 FTE (full time equivalent) according to Sandra Peaks, FinCEN Personnel Director.

⁸ "The Global Fight Against Money Laundering: Background." US Department of the Treasury: FinCEN. www.ustreas.gov/treasury/bureaus/fincen/border.htm.

⁹ Rosenberg.

form of approximately 8000 intelligence reports per year¹⁰ and through numerous efforts such as Project Gateway, which allows local law enforcement agencies on-line access to FinCEN's databases.¹¹

B. Purpose

Law enforcement agencies possess limited resources, time, and energy in the face of an immense and complex problem. In the fulfillment of its mission, FinCEN helps law enforcement agencies overcome these limitations by providing analytical support. To do this, FinCEN must constantly endeavor to better understand money laundering and the environment in which it takes place. This Policy Analysis Exercise seeks to help FinCEN support law enforcement agencies by providing answers and corresponding policy recommendations stemming from three key questions raised by FinCEN analysts.

C. Methodology

The analysis proceeds by defining the problem and providing background information on money laundering before answering FinCEN's questions and deriving recommendations from them. It relies heavily on interviews with FinCEN's analysts and associates as well as documents from FinCEN, the Financial Action Task Force (FATF), academic papers and journals, and other books and articles on money laundering. The analysis includes current information about money laundering, its economics, and future predictions.

D. Guiding Values

¹⁰ "FinCEN's Frequently Asked Questions: Who are FinCEN's Customers?" US Department of the Treasury: FinCEN. **Error! Bookmark not defined.**.html/#problem.

¹¹ According to Tom Kleiner, a FinCEN analyst, substantial assistance to state and local law enforcement is also provided by FinCEN's Office of Investigative Support that addresses criminal proceeds. This support often provides leads that undermine criminal activity through investigations and prosecutions.

Recommendations for FinCEN should adhere to certain guiding values. These values are based on FinCEN's mission in a free society and their political and budgetary realities. Recommended policies should:

1. Be realistic. The recommendations should be reasonable given FinCEN's current and future mandate, budget, staffing, and expertise. Furthermore, the recommendations must acknowledge that they will not put an end to money laundering or crime.
2. Support law enforcement agents and regulators in their efforts to increase the difficulty and risk of participating in money laundering activities.
3. Respect privacy rights and the free market tradition. Neither individuals nor the business sector should be over-regulated or unduly intruded upon.

III. Problem Definition

Dwarfed by the magnitude of money laundering and possessing limited resources, FinCEN must help others place their time, effort, and money where they can have the largest impact. To do this most effectively, FinCEN requires excellent information about money laundering. In early meetings with FinCEN, its analysts laid out three unanswered questions they believed were key to understanding and accomplishing their mission.

These questions are:

- A. Is good¹² information available on the costs and magnitudes of money laundering?**
- B. Does increasing the price of laundering reduce crime?**
- C. What will be the impact of future technology on FinCEN's ability to help combat money laundering?**

The following analysis answers these questions and provides policy recommendations to aid FinCEN in the fulfillment of their mission.

¹² For the purposes of this analysis, "Good" information refers to information that is valid and complete. "Valid" is synonymous with "accurate" and "reliable."

IV. Background

A. History of Money Laundering

Law enforcement agents who specialize in financial crimes are well known for stating that money laundering is the second oldest profession. There is truth to their joking belief. The earliest doers of illicit deeds likely required means to disguise their proceeds from authorities--commonly known today as "money laundering." During the early 20th Century, as organized crime in America expanded deep into gambling and the drug trade, a parallel financial system evolved to cleanse money gained from criminal activities.¹³ Today there are many methods to "launder" illegally obtained proceeds but the end goal remains the same--disguise assets so they can be used without detection of the illegal activity that produced them.

B. What is money laundering?

Traditionally, money is used as a medium of exchange, as a unit of account, and as a store of value. The use of illegally obtained, or "dirty," money is complicated because it can link its owner to the criminal activity that produced it. Thus, criminals have three needs with respect to their illegal cash flow: to control it, to conceal its origin, and to change its form. "Money laundering" is the process by which these needs are fulfilled. While the "...techniques of money laundering are innumerable, diverse,

¹³ Naylor, Robin. Hot Money and the Politics of Debt. New York: The Linden Press/Simon and Schuster. 1987. Pg. 20.

complex, subtle and secret...,”¹⁴ they usually entail three steps: placement, layering, and integration. Funds that have experienced each step are said to be “cleansed.”

Placement involves injecting the illicit funds into the financial system. Successful placement requires that it be unnoticed by authorities. “Structuring” is one form of placement and involves dividing up large sums of money among various “smurfs” who place the money into the financial system piecemeal to avoid reporting requirements. *Layering* describes distancing the funds from their illegal source by “...conducting a series of financial transactions which in their frequency, volume, or complexity, resemble legitimate transactions.”¹⁵ *Integration* is the final step whereby the funds are introduced into the economy with a seemingly legal paper trail.

Launderers are most susceptible to detection during placement. This is due to two factors: the immense volume of cash, and the need to place it in the legitimate financial system. A criminal organization in Chicago, selling \$1 million of cocaine must transport and distribute only 44 lbs. of the drug while they will have to contend with 256 lbs. of street cash. For comparison, \$1 million of heroine only weighs 22 lbs.¹⁶ The combination of these two factors makes “placing” the large quantities of cash into the financial system the most detectable of laundering activities.

For this reason money launderers usually seek to transport illegal funds out of countries with tightly controlled financial systems as illicit proceeds are more easily

¹⁴ International Narcotics Control Strategy Report: March 1, 1988. U.S. Department of State. Washington, DC. Pg. 46.

¹⁵ Sabbag, Robert. “Money Laundering: Hot Crime.” Rolling Stone. August 21, 1997. Pg. 81, at 83.

¹⁶ Warren, Mary Lee, Deputy Assistant Attorney General. *Before the Sub-committee on Crime, Committee on the Judiciary, United States House of Representatives, Concerning Money Laundering and Drug Trafficking*. Federal Document Clearing House. July 24, 1997. Pg. 1-2. Calculations based on the average weight of \$5s, \$10s, and \$20.

cleansed in countries with lax controls. Expatriation of “dirty” proceeds takes place in three main ways.¹⁷

1. Convert it to something portable, whether merchandise or a negotiable financial instrument, to make its transfer appear legitimate.
2. Get it into wire transfer form for movement electronically, relying on the rapid pace and volume to avoid detection; or
3. Conceal it and ship it out as freight.

C. Who are the Money Launderers?

Two main groups participate in large-scale money laundering operations: criminal organizations that launder their own money and professional money launderers.

Traditionally, criminal organizations launder their own money. As laundering becomes more difficult and risky, criminals outsource—either contracting their laundering out to professionals or simply selling their illicit funds at a discount. Money launderers, or money brokers, need not appear part of the criminal element. They are often more aptly portrayed as professional financial risk managers, lawyers,¹⁸ businessmen, or economists. These “brokers” are insulated from the originating crime which helps to erode the connection of the funds to the illicit activity.

D. Why is Money Laundering Bad?

There are two main threats posed by money laundering. *First*, money laundering provides criminals with the funds to operate and expand their criminal enterprises. Without the ability to use profits, made possible by money laundering, there is no economic incentive for criminal behavior and no funds to support it. *Second*, money laundering damages the legitimate institutions that it infiltrates. Most commonly money

¹⁷ Sabbag.

laundering erodes the integrity of a nation's financial institutions which can lead to economic and political instability. Instability is caused by supporting criminal organizations that penetrate and corrupt governments, by creating the widespread perception that the nation's banks are untrustworthy--thereby depriving the financial system and industry of resources,¹⁹ and by allocating scarce resources based on secrecy rather than market fundamentals. These effects distort markets and deter legitimate capital.²⁰

Consequently, countries have incentives to enact anti-money laundering laws.²¹ To possess a reputation as a sophisticated financial center, a country must have good anti-money laundering laws, according to George Graham of the Financial Times.²² Secrecy legislation does not help this image. Countries that lag, or are perceived to lag, behind in adopting money laundering legislation will soon become havens for criminal proceeds and little else.²³

E. Why is Laundering Especially Attractive to Law Enforcement?

¹⁸ The involvement of lawyers is particularly attractive since many countries allow special secrecy citing attorney--client confidentiality.

¹⁹ Baisle Committee on Banking Regulations and Supervisory Practices. "December 1988 Statement on Prevention of Criminal Use of the Banking System for the Purposes of Money Laundering." Commonwealth Secretariat, London. Gilmore, W.C., International Efforts to Combat Money Laundering. Pg. 273, at 276.

²⁰ Vito Tanzi, author of an IMF working paper, believes that while small countries think that the inflow of money will help them achieve prosperity it actually hurts them by misallocating scarce resources, not by market fundamentals, but rather, by their own priorities. Therefore it distorts the markets and drives out legitimate investments. August, Oliver. "Governments Gunning for Money Launderers." The Times. London. October 1, 1996. Business.

²¹ The U.S. State Department observes that, "Reducing money laundering is essential as political stability, democracy, and free markets, depend on solvent, stable, and honest financial, commercial, and trade systems." 1997 International Narcotics Control Strategy Report: March 1, 1988. U.S. State Department. Washington, DC. Pg. 46.

²² Graham, George. "The Cash Courier' Runs Out of Time." Financial Times. March 18, 1997. Pg. 4.

²³ Mr. John Brum, Chairman of the Asian Group of the Financial Action Task Force (FATF) in: Bardacke, Ted. "Asia Warned of Money Laundering Dangers." Financial Times. February 28, 1997. Pg. 6.

While law enforcement agencies often find it difficult to combat money laundering, there are a number of reasons why such targeting is especially attractive. E. Nadelmann best expressed this in his 1986 paper, "Unlaundering Dirty Money Abroad: US Foreign Policy and Financial Secrecy Jurisdictions."

"The most basic of these [reasons] is that insofar as criminals ... act as they do for the money, the best deterrent and punishment is to confiscate their incentive. A *second* rationale is that, while the higher level and more powerful criminals rarely come into contact with the illicit goods, such as drugs, from which they derive their profits, they do come into contact with the proceeds from the sale of those goods. That contact often provides a 'paper trail' or other evidence, which constitutes the only connection with a violation of the law. A *third* rationale is that confiscating the proceeds of criminal activities is a good way to make law enforcement pay for itself."²⁴

With an understanding of the background of money laundering, we now turn our attention to answering FinCEN's questions and developing recommendations.

²⁴ Nadelmann, E. "Unlaundering Dirty Money Abroad: US Foreign Policy and Financial Secrecy Jurisdictions." 18th Inter-American Law Review, 1986. Pg. 33, at 34.

V. Development & Analysis of Questions

A. Is Good Information Available on the Costs & Magnitudes of Laundering?

1. Why Would Good Information be Useful?

Before determining whether good (meaning valid and complete) estimates of the costs and magnitudes of money laundering exist, it is important to understand why good estimates matter. According to Malcolm Sparrow, professor at the Kennedy School of Government and author of "Network Vulnerabilities and Strategic Intelligence in Law Enforcement," "In seeking to incapacitate criminal organizations one obvious approach is to identify those players who are somehow central, vital, key, or pivotal, and target them for removal or surveillance."²⁵ Good estimates of the costs of laundering activities would help determine which individuals or activities can be efficiently targeted by law enforcement. Good estimates of the magnitudes of money laundering, broken down into specific geographic regions and types of laundering (i.e. white collar crime vs. drug trafficking), would help identify the illicit proceeds and their methods of transfer for more efficient targeting.²⁶ A lack of good information on the costs and magnitudes complicates this identification and the corresponding strategic analysis, thus diminishing FinCEN's ability to support law enforcement agencies.²⁷

²⁵ Sparrow, Malcolm. "Network Vulnerabilities and Strategic Intelligence in Law Enforcement." *International Journal of Intelligence and Counterintelligence*. Volume 5, No. 3. Page 261.

²⁶ Some analysts believe that scarce resources should be dedicated to combating crime instead of determining the total magnitude of laundering since having better estimates of the total magnitude of money laundering may be of little use. It is important to note that it is the break-down of the specific magnitudes of the types of laundering and their geographic regions that is most useful to law enforcement.

²⁷ Better estimates of the magnitude of money laundering may help to measure the effectiveness of anti-money laundering efforts. However, it is unclear how useful good information would be as a proxy for successful law enforcement since the magnitude of money laundering may depend on other factors such as the amount of crime, exchange rate policy, taxation, etc.

2. Estimates of the Cost of Money Laundering.

Current estimates of the cost of money laundering range from 15-20%.²⁸ That is, it costs \$0.15 to \$0.20 to launder each dollar, leaving the criminal with \$0.80 to \$0.85 of cleansed revenue. Drug Enforcement Administration estimates are similar as they report that criminals have to tolerate money laundering costs of 17% or more.²⁹

These cost estimates have not remained constant over time. Available evidence suggests that the price of money laundering services has increased since the 1970s when the cost of money laundering was as low as 1%.³⁰ According to Mary Lee Warren, Deputy Assistant Attorney General, in Congressional testimony, "Ten years ago the cost to launder money was approximately 5-7%."³¹ These lower prices are corroborated by the Financial Action Task Force that reports commissions of 2-4% in the U.S. during the early 1980s.³² The price increases are attributed to the increased risk and complexity of money laundering as financial system protection and law enforcement efforts have grown substantially. During the 1970's and early 1980's money laundering was much simpler with "smurfs" and drug dealers doing the work themselves. As professional laundering operations have grown in sophistication they have incorporated lawyers, financial managers, and economists. Although the estimates vary, the increase in the cost of U.S. money laundering since the 1970s is widely recognized.

a. How do we know the costs? What methods are used to gather the data?

²⁸ Interview with Greg Passic, former FinCEN analyst. November 21, 1997.

²⁹ Deputy Attorney General Phillip Heymann as reported in "Top Justice Deputy Voices Policy Priorities Under Reno." Money Laundering Alert. Vol. 5, No. 2; November, 1993. Pg. 4.

³⁰ Ibid.

³¹ Warren. Pg. 10.

³² "FATF Report on Money Laundering," 6 February, 1990; in Gilmore, W.C., International Efforts to Combat Money Laundering. Pg. 4 at 5.

Estimates of the price of money laundering are usually based on information about the laundering of drug money, which is easiest to identify. Estimates are taken from information gathered from individual cases, then judged to be reasonable or unreasonable, and, if believable, become generally accepted.

The best estimates come from information on cocaine sales. From the testimony of convicted drug dealers, it costs about \$3000 to get a kilogram of cocaine to market in Los Angeles where it will sell for approximately \$20,000. From this revenue the drug dealer will receive approximately \$17,000 after cleansing the cash. Hence, the 15% laundering price.³³

b. Problems with these methods.

Despite being generally accepted, and possibly correct, the 15-20% figure suffers from several problems. First, the focus on drug related money laundering means there is little information on the going rate for other crimes such as tax evasion and gambling. Second, the price estimates are not broken down into the individual costs of laundering activities. Rather, it is all lumped together. This does not allow FinCEN to pinpoint critical steps in the laundering process that are susceptible to large increases in costs. If, for example, FinCEN knew that maintaining business fronts was an important, yet inexpensive, part of the launderer's operation, it could recommend that law enforcement agents focus on increasing the costs to maintain false business fronts,³⁴ thus significantly increasing the costs of laundering with a minimum of resources.

3. Magnitude of Money Laundering.

³³ $(\$3000/\$20,000) = .15$. Passic.

³⁴ Possibly coordinating with state licensing agencies to provide increased scrutiny of business applications.

Estimates of the world-wide magnitude of money laundering range from \$300 to \$500 billion.³⁵ U.S. estimates range from \$50 to \$200 Billion.³⁶ Obviously, little confidence should be placed in these estimates as they are highly suspect. The Financial Action Task Force recognizes that, "the vast majority of FATF members lack sufficient data to support *any* credible estimate."³⁷ Even this may be an overstatement as *no country* seems to have credible estimates. One additional problem is that the estimates often do not break the magnitudes into their various geographic regions or types of laundering which would help focus law enforcement efforts.

a. How do we know the magnitudes? What methods are used to gather data?

In the United States, the best estimates of money laundering come from the addition of reasonable estimates taken from the drug trade as well as estimates "pulled out of the air" of the other components of money laundering. For example, the Office of National Drug Control Policy (ONDCP) estimates that the US drug trade is \$57 Billion annually.³⁸ Combining this with the estimates of several FinCEN analysts that other crime is responsible for another \$40-\$50 Billion, approximately \$100 Billion is laundered each year in the US.³⁹

³⁵ U.S. Congress, Office of Technology Assessment, *Information Technologies for the Control of Money Laundering*, OTA-ITC-630 (Washington, DC: U.S. Government Printing Office, September 1995).; and Trigaux, Robert. "The Dirty Business of Cleaning Cash." *St. Petersburg Times*. 20 October 1995.

³⁶ Estimates from interviews with FinCEN analysts and articles. Trapp, Roger. "Big Trouble With Dirty Money." *The Independent*. May 24, 1995. Pg. 27.; "The Global Fight Against Money Laundering: Background." US Department of the Treasury, FinCEN. **Error! Bookmark not defined.** treasury/bureaus/fincen/ border.htm.; Royce, Knut. "The Money Trail." *Newsday*. Dec. 17, 1989. Pg. 10.; U.S. Congress, Office of Technology Assessment, *Information Technologies for the Control of Money Laundering*, OTA-ITC-630 (Washington, DC: U.S. Government Printing Office, September 1995.) Pg. 2.

³⁷ "1996-1997 Report on Money Laundering Typologies." Financial Action Task Force on Money Laundering. <http://www.oecd.org/fatf/fatfviii.htm#II>. Pg. 3.

³⁸ "Colombian Black Market Peso Exchange." FinCEN Advisory: Issue 9. US Department of the Treasury, FinCEN. November 1997. Pg. 1.

³⁹ Interview with Stanley Morris, Director, FinCEN. November 21, 1997.

b. Problems with these methods.

Clearly, these methods lack adequate analysis. Many of the estimates do not appear to be based on sound documented evidence but rather referenced from previous undocumented figures.⁴⁰ The very large range of estimates (i.e. \$50-\$200 Billion) as well as the credence given to educated guesses and circular reasoning are troubling.

Unfortunately, money laundering tends to be "victimless,"⁴¹ which results in the vast majority of money laundering going unreported and the corresponding reliance on educated guesses. If all crime required money laundering services, we could total the value of this crime and then use it as a proxy for the magnitude of money laundering. However, the vast array of crime, and how it relates to money laundering, is very difficult to ascertain.

Estimations of the amount of financial flows using international banking and balance of payment's accounts seems like a good idea, but there are not yet feasible methods for disaggregating crime from legal commerce.⁴² Furthermore, international accounting methods suffer from insufficient information on offshore financial institutions, according to the Financial Action Task Force (FATF.) Add to this the occurrence of double-invoicing and under-invoicing that have opposite effects on official statistics, and it is impossible to determine, directly, from current statistics, the magnitude of money laundering.⁴³

⁴⁰ This observation was made most persuasively by Tom Kleiner.

⁴¹ Interview with Tom Ryder and Charles Klingman, FinCEN analysts. November 21, 1997. Of course the unlawful activity which creates the illicit cash often has victims.

⁴² "FATF Report on Money Laundering," 6 February, 1990; in Gilmore, W.C., International Efforts to Combat Money Laundering. Pg. 4 at 5.

⁴³ Ibid.

FATF also found that indirect methods, based on the estimated amount of drugs, needs of drug abusers, or seizures are ineffective.⁴⁴ Even knowing the exact amount of drug money does not provide any information about the laundering magnitude for other criminal enterprises such as white collar crime.⁴⁵

4. Reasons for FinCEN's Information Gaps.

These information gaps exist for several reasons. First, analysts are inundated with investigations, which results in little follow-up after most cases as limited resources are needed elsewhere. Second, while FinCEN is tasked with providing strategic analysis, it is reliant on over-tasked law enforcement agencies for much of the best information needed for such analysis. Law enforcement agents are often more focused on arrests and seizures than on interviewing criminals and recording data for strategic analysis. Consequently, if information is not directly related to a specific case it is easily overlooked. Adding to this problem, FinCEN may be seen as an outsider by law enforcement agents who do not understand its role and who are generally distrustful of agencies which might be trying to steal away some of their credit. The result is that the people most capable of providing strategic analysis may be removed from the information with which to accomplish it.

Another reason for poor information is identified by analysts who believe that law enforcement intelligence often lacks true analysis—analysis that gives data further meaning.⁴⁶ Low quality analysis may not encourage further data collection or analysis

⁴⁴ Ibid.

⁴⁵ According to FBI statistics white collar crime accounts for 46% of money laundering convictions obtained under 18 U.S.C H 1956 and 1957. "Laundering of Monetary Instruments" and FDCH Congressional Testimony, July 24, 1997.

⁴⁶ Interview with Cordell Hart. November 21, 1997.

since it has little value. Finally, law enforcement, by its very nature, only sees some money laundering. The best launderers are never caught. This complicates the collection of valid and complete information.⁴⁷

5. How Should FinCEN Act in the Absence of Good Information?

In the absence of good information, FinCEN has little choice but to maintain the status quo and seek better information. Realizing this need, FinCEN recently announced a five-year goal to develop a "viable model for measuring the magnitude of money laundering."⁴⁸ The following section outlines two steps to get better information on both the price and magnitude of money laundering.

6. Ways to Get Better Estimates of Price and Magnitude.

a. Dedicating resources for collection, analysis, and distribution of information.

The first and most important step toward getting better information is to dedicate resources to collect, analyze, and distribute current data and information. Because of the limits of statistics and gathering methods, much of the data and information will still suffer from the same problems already identified. However, conducting comprehensive collection and analysis can minimize these concerns. FinCEN analysts should conduct interviews with convicted launderers, criminals, informants, and undercover agents. FinCEN should also focus on reviewing case files for valuable information. The costs and magnitudes of white collar and other crime should be analyzed to avoid focusing solely on drug-related laundering. Furthermore, the researchers should seek to pinpoint the costs of individual activities of launderers as well as the magnitudes of various types

⁴⁷ Ryder and Klingman.

⁴⁸ "FinCEN Plan Promises Agents Monthly 'Targeting Packages.'" Money Laundering Alert. Vol. 9, No. 2. November 1997. Pg. 3.

of laundering and specific geographic regions. A comprehensive study of current information will likely be much better at analyzing the price of laundering than the magnitude of money laundering since the collection methods for information on costs have fewer problems. For improvements in the estimates of the magnitude of money laundering, efforts such as Geographic Targeting Orders may be useful.

b. Geographic Targeting Order

The *Anunzio-Wylie Act of 1992* expanded the *Bank Security Act of 1970* to allow for Geographic Targeting Orders (GTOs). GTOs allow law enforcement agencies to require money transmitters, in designated geographical areas, to report information to the Department of the Treasury on cash remittances of \$750 or more to designated countries. GTOs last for 60 days but can be renewed. They are intended to displace money laundering organizations but they are also proving useful in determining the magnitudes of money laundering since a strong causal relationship may be demonstrated by wide swings in the volume of money transfers when they are implemented. For example:

“Before the New York GTO went into effect, between October 2, 1995 and January 27, 1996, South American Exchange Ltd (SAE) sent more than 11,000 remittances totaling \$40.3 million. [Once the GTO went into effect] SAE sent 384 transmittals to Colombia from October 1996 through January 1997 totaling only \$813,000.”⁴⁹

Although this example is only a small subset of the total magnitude of money laundering, it represents some of the best available information. The GTO may have an important

⁴⁹ “Top NY Transmitter Rewarded Agents for Structuring, U.S. Says.” *Money Laundering Alert*. Vol. 8, No. 11. August 1997. Pg. 5.

role to play, not only in combating money laundering, but also in measuring its specific magnitudes.⁵⁰

According to Mary Lee Warren, Deputy Assistant Attorney General, "Geographic Targeting Orders are most effective when resources and personnel are allotted in advance to detect the movement of cash by other means."⁵¹ If FinCEN is prepared to monitor the changes in magnitudes of cash flows during newly introduced law enforcement measures it could begin to differentiate the licit from the illicit and greatly improve current estimates. This monitoring could include interviewing informants and undercover operatives who are in place to witness the disruption and displacement. It could also involve using data sources such as suspicious activity reports (SARs), which are filed by financial institutions, and "spikes" in reported highway seizure statistics to follow the currency flows from affected areas to other suspected "flight" areas.⁵²

B. Does Increasing the Price of Laundering Directly Reduce Crime?

FinCEN's second key question is whether increasing the price of money laundering reduces crime? If increasing the price reduces crime, the solution to end profit-oriented crime is simply to increase the cost of money laundering. For a criminal enterprise to be viable, it must return a profit. Therefore, its activities, including money laundering, are economic endeavors⁵³ and should be analyzed using an economic approach.

⁵⁰ For example, the reported reductions in the value of money transfers between New York and Colombia when the GTO began could be used to support or compose estimates of the New York to Colombia money laundering using money transmitters.

⁵¹ Warren. Pg. 5.

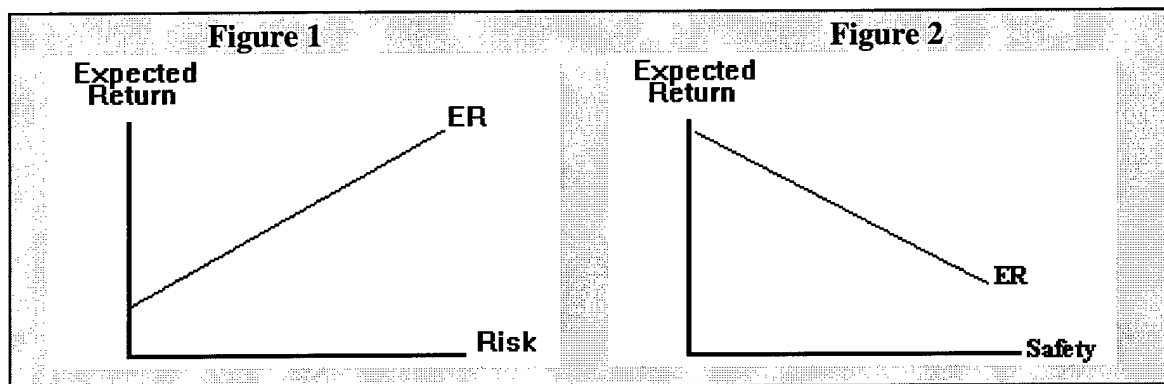
⁵² Mike Rosenberg made this explicit.

⁵³ Hart. Pg. 3.

1. Demand for Money Laundering is Inelastic.

Ingo Walter, of Columbia University, did just such an economic analysis in his 1993 paper, "The Economics of International Money Laundering."⁵⁴ In his paper, Walter contrasts the money launderer with the financial manager who concerns herself with the tradeoff between expected return and risk. This tradeoff is presented in *Figure 1*. Risk-free assets provide a low expected return while higher levels of risk require a higher expected return. The result is a positive relationship between risk and expected return (ER.) Walter inverts the risk axis and calls it, "safety" (1/Risk) for illustrative purposes.⁵⁵

Figure 2 represents this change.



Walter then includes the additional requirement of confidentiality.⁵⁶ There may be legal or illegal reasons for such confidentiality. In both cases the need for confidentiality, or secrecy, imposes a further tradeoff. Individuals will pay for additional units of secrecy with a lower expected return or lower safety according to Walter.⁵⁷ The historical example of countries such as Switzerland and off-shore banking meccas such as the Cayman Islands, whose banks were able to pay below market returns on deposits in return

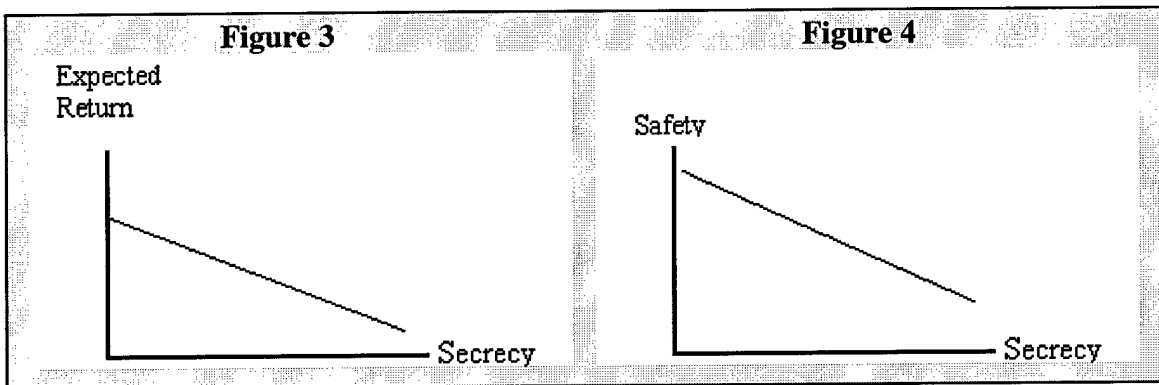
⁵⁴ Walter, Ingo. "The Economics of International Money Laundering." Papers on Latin America #31. September 1993.

⁵⁵ Ibid. Pg. 3.

⁵⁶ Ibid. Pg. 2.

for their tight secrecy provisions,⁵⁸ supports this conclusion. *Figure 3* depicts this tradeoff.

Walter's tripartite analysis assumes one more tradeoff--that between safety (1/risk) and secrecy. These two have a negative relationship (positive for risk v. secrecy) as the need for secrecy decreases the portfolio's safety.⁵⁹ According to Walter, not only is there reduced safety from the requirement of additional secrecy to prevent the criminal from going to jail, but safety also declines from the money launderer's new inability to hedge the portfolio by investing across countries or industries.⁶⁰ This occurs as launderers are forced to avoid countries or industries that are not conducive to money laundering activities. *Figure 4* represents this tradeoff.



When forced to choose between expected return or safety, and secrecy, the criminal will prefer additional units of secrecy. Simply stated, "...in money laundering, the secrecy premium is primary. A launderer may sacrifice a great deal of yield and assume lower safety to avoid disclosure since the dis-utility from discovery is so great."⁶¹

⁵⁷ Ibid.

⁵⁸ Naylor, Robert. *Hot Money and the Politics of Debt*. New York: Linden Press/Simon and Schuster., 1987. Pg. 32.

⁵⁹ Walter. Pg. 3.

⁶⁰ Ibid. Pg. 2.

⁶¹ Ibid. Pg. 24.

Adapting Walter's model for our analysis results in *Figure 5* which combines safety and expected return on the vertical axis and depicts their negative relationship to increased units of secrecy. *Figure 5* portrays the reality that a criminal's need for secrecy far outweighs requirements for expected return or safety—the need for secrecy is inelastic. Further simplifying these tradeoffs allows us to translate *Figure 5* into a rough price versus quantity graph for the supply of money laundering services (*Figure 6*.)

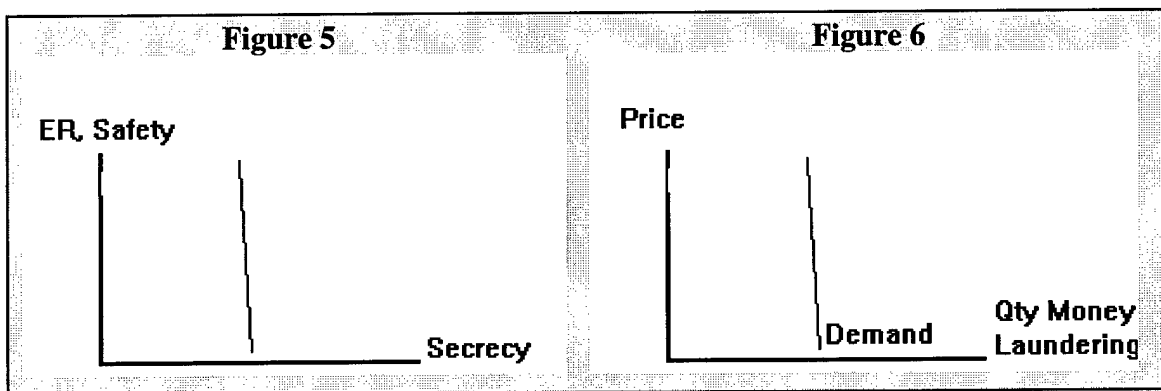
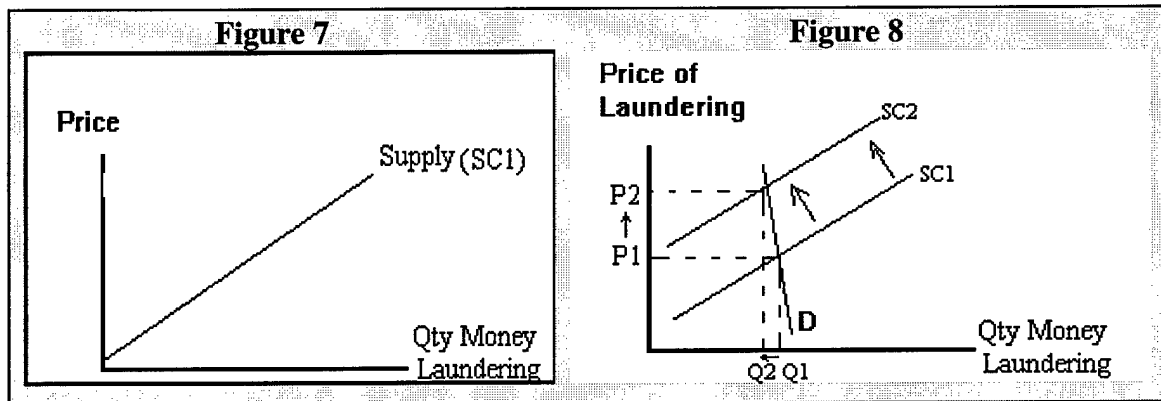


Figure 6 represents the fact that a criminal's demand for money laundering services is price inelastic as they must have secrecy to avoid jail, fines, or asset seizure. For a given demand curve, the quantity of money laundering demanded by criminals will vary little with changes in the price of laundering services. For further understanding of the effect of changes in price, a basic understanding of the supply of money laundering services is useful.

2. Intersection of Demand and Supply & the Fundamental Problem.

A normal price versus quantity graph is sufficient to represent the basic intuition that more laundering services will be supplied as the rewards for laundering increase. *Figure 7* represents this positive relationship between the price and quantity of money laundering services supplied. The intersection of the demand and supply curves

determines the price and magnitude of money laundering. Since demand is price inelastic, a cost-based shift in the supply of money laundering services (an increase in cost from SC1 to SC2) results in a small change in the magnitude of money laundering (Q1 to Q2) and a large change in the price (P1 to P2) as represented in *Figure 8*.



The fundamental problem for law enforcement agents is that individuals requiring money laundering will gladly pay for it as their expected returns still far exceed those in the licit market. Despite the tremendous need for secrecy, criminal organizations will continue to demand money laundering as long as their cost does not exceed their criminal revenues. With cocaine based organizations experiencing average returns of 466% on their initial investment,⁶² there is little threat of this occurring anytime soon. Thus, the criminal will gladly pay price P2.⁶³

a. Increasing the price of laundering will not reduce crime.

Since the criminal has no substitute for money laundering services and their requirement for secrecy is so great, increases in the price of laundering services will not reduce the demand for money laundering services. Realizing that the criminal's demand

⁶² Passic.

⁶³ Germaine Perambo, a FinCEN analyst, correctly points out that not all criminals have unlimited cash flows. Therefore, increasing the price of laundering services, for some criminals, may reduce their crime.

for money laundering services is essentially the amount of crime they commit, increasing the price of laundering services will not reduce crime.

In economic terms, the criminal's consumer surplus is very large. The consumer's surplus is the difference between what criminals have to pay for the money laundering and what they are willing to pay for it. Criminals are willing to pay a great deal for secrecy that allows them to use their immense proceeds. While efforts have increased the going rate for money laundering, discussed previously, this is a tradeoff that criminals are willing to make. The only time that crime is unprofitable is when the criminal goes to jail and loses all assets.⁶⁴

3. What then—What Methods Help Combat Crime?

While increasing the price of laundering services does not reduce crime, a higher price likely indicates a more risky environment for the criminal. This is because as law enforcement increases the pressure on criminals they must go to additional, and often more costly, lengths to conceal their illegal incomes. Consequently, an extremely effective way to increase the pressure on criminals is to displace their traditional laundering mechanisms.

a. Combating money laundering and crime with displacement.

"Displacement" occurs when money launderers, criminals, or their cash flows are forced out of their normal operations.⁶⁵ FinCEN agents use an analogy of a water balloon to describe how in money laundering "when you poke it in one place, it pops out in another." This analogy could not be more accurate. As law enforcement agents and

⁶⁴ Interview with Ed Doyle, FinCEN, Office of Research and Development. November 21, 1997.

⁶⁵ "Displacement" is very closely linked with "disruption." Disruption of the criminal's enterprise eventually leads to displacement (Kleiner.)

regulation crack down on laundering in one area, criminals move to new geographic regions. A downward trend in laundering in one area is reflected as an increase in another.⁶⁶

b. How displacement works.

Displacement increases the vulnerabilities and risks of criminals by forcing them to develop new laundering methods and organizations or return to old ones. In each case, the change presents additional opportunities for detection. Ronald Noble, former Treasury Undersecretary for Enforcement, believes that these displacement methods increase the risks of criminals because they "...increase their exposure to being caught."⁶⁷ The vulnerability and risk will be ever-more apparent if law enforcement agents anticipate the shifts and position themselves to detect them.⁶⁸

c. Causing displacement.

To cause this displacement in the first place, law enforcement must be able to affect money launderers. Strategic intelligence and analysis can help law enforcement agencies determine where to target launderers but we have already explained how the lack of information makes such analysis difficult. Ironically, monitoring the displacement of laundering organizations and their transfer methods provides valuable information about

⁶⁶ For example, according to Federal Reserve data, in 1985 the Miami area had a surplus cash reserve of \$6 billion that shrunk to \$4.8 billion by the late 1980s as the Miami area came under increased pressure from law enforcement. Meanwhile, the cash surplus in the Los Angeles region increased from \$165 Million to \$3.8 Billion. By 1996 LA's cash surplus was \$14.4 Billion, making it the FBI's top market for laundering money according to: Trigaux, Robert. "The Dirty Business of Cleaning Cash." St. Petersburg Times, October 20, 1997. Pg. 10. The reader must bear in mind that Reserve regional currency flow surpluses are not to be perceived as being per se indicative of any suspected money laundering activity. Any such analysis must carefully examine and assess legitimate commercial activities that may contribute to fluctuations according to Mike Rosenberg.

⁶⁷ Blustein, Paul. "26-Nation Group Presses Fight Against Laundering of Money." Washington Post. June 29, 1996. Pg. D1.

⁶⁸ Warren. Pg. 4.

the magnitudes and routes of money laundering—information that can help identify further laundering and crime. Thus, gathering information from displacement activities, for strategic analysis, helps target, and therefore displace, additional crime.

Without specific information on the costs and magnitudes of money laundering we realize that the launderer's greatest asset—their organization, is the best target for displacement. The launderer's organization often consists of smurfs, couriers, corrupt officials, business fronts, and contacts. Their organization is their ability to smuggle and change currency into clean forms.⁶⁹ Displacing their organization reduces the criminal's ability to launder money and forces them to develop new networks--a risky endeavor. Advertising for new members and setting up shop in new areas creates many opportunities for observation by law enforcement,⁷⁰ thereby making criminals more susceptible to prosecution and asset-seizure--acts that reduce crime.

A launderer's methods of funds transfer are also vulnerable to displacement. While much of the recent information on transfers of illegal profits focuses on new means of electronic transfer, a large portion of the traffic is still done by traditional means such as bulk smuggling of cash and underground banking systems.⁷¹ Closing down individual routes of transfer and forcing criminals into other channels is an obvious method of displacement which makes crime more risky. One caveat to this temporary displacement is that law enforcement should be careful not to squeeze illicit proceeds from methods like bulk shipping into important institutions such as banks.

⁶⁹ Doyle.

⁷⁰ Developed from a discussion with Professor Malcolm Sparrow.

⁷¹ Hart. Pg. 3.

The use of Geographic Targeting Orders (GTOs) is a good example of law enforcement effectively displacing laundering organizations and their transfer methods to increase seizures and prosecutions. When the New York GTO first went into effect in 1996 illicit cash seizures increased, “across the nation in Boston, and Miami, and other areas as New York drug dealers looked for new areas to remit their proceeds.”⁷² As additional pressure was applied in New York, criminal funds and the laundering organizations that handle it, were displaced. Although a GTO can be circumvented using intermediaries in non-targeted areas, it invalidates the criminal’s established network and forces them to rely on traditional methods of smuggling. These traditional methods of smuggling can be more vulnerable to detection, especially when law enforcement agencies are coordinated and they expect heightened traffic.⁷³

Once in foreign countries, assets are more easily exchanged into licit foreign currency for introduction into the financial system. While displacing these transactions would increase the vulnerability of the criminal, doing so is problematic for U.S. authorities that do not have jurisdiction. Further government control, regulation, and criminal codes can also displace laundering activities, thus making the criminal increasingly vulnerable. However, these methods tend to be less flexible, are more easily adapted to by criminals, and impose additional costs on legal commerce.

4. Aiding Displacement Strategies.

FinCEN can aid law enforcement in the reduction of crime by educating them about the important role of displacement in combating money laundering and by

⁷² Warren. Pg. 4.

⁷³ Ibid.

facilitating coordination among law enforcement agencies to recognize and detect displaced criminal activity and proceeds. This facilitation may take the form of coordinating undercover operations to be in place to monitor and report changes in the launderer's operations, heightened coordination of surveillance efforts in affected areas and suspected "flight" areas, and coordinated debriefings of key informants.⁷⁴

C. What Will Be the Impact of Future Technology on FinCEN's Ability to Help Combat Money Laundering?

1. Technology to Help Criminals vs. Technology to Help Law Enforcement.

a. Technology to Help the Criminal.

The primary technologies that have law enforcement agents concerned are new payment systems such as cyber-currencies and stored-value cards. Cyber-currency is currency that is transacted on the internet via computers while stored value cards allow the user to place money onto a card for use similar to a debit or ATM card. The potential problems of these new systems are expressed by Dr. James Blackhouse, of the Computer Security Research Centre at the London School of Economics, who believes that accounting firms will be unable "to follow money round the world, and root out who is sending 'dirty' money where..."⁷⁵ His ideas are founded on the belief that financial institutions "will cooperate with criminals to hide illegally obtained money."⁷⁶ Blackhouse believes there is nothing to prevent criminal organizations from becoming providers of the new services and that "the whole underpinning of regulation is going to

⁷⁴ Rosenberg.

⁷⁵ James Blackhouse in: Gosling, Paul. *The Independent* (London) May 28, 1997. Pg. 16.

⁷⁶ Ibid.

rot away, and rapidly.”⁷⁷ Going even further is Rowan Bosworth-Davies, author of The Impact of International Money Laundering Legislation, who states that, “...electronic currency could end the concept of society as we know it,” since it will be possible to avoid all taxation.⁷⁸

While new payment technologies certainly pose challenges for FinCEN, there are two inadequacies with these doomsday visions. *First*, and most important, illicit money will still require some form of placement. The difference is that placement may take a new form. Instead of requiring financial intermediation, criminals may be able to avoid placement into the traditional financial system which regulators and law enforcement agencies use as “choke points” for illicit proceeds.⁷⁹ Even if criminal organizations become providers of these new technologies to take advantage of the very low organization, transportation, and transaction costs and eliminate normal financial intermediation, they will still face the problem of having very large amounts of illicit proceeds. These proceeds must be injected into the financial system or a parallel system, either during the normal placement stage or during integration. If these injections do not occur until integration they will be much more difficult to detect. However, if law enforcement agents identify the new methods of injecting funds they should be able to adapt and avoid becoming obsolete.

A *second* inadequacy of doomsday predictions, stemming from the use of new payment technologies, is that until there is sufficient commercial volume, money launderers will be hampered from using them on a large scale. This is because there must

⁷⁷ Ibid.

⁷⁸ Rowan Bosworth-Davies in Gosling, Paul. The Independent (London) May 28, 1997. Pg. 16.

be sufficient trade in the new payment systems to camouflage criminal transactions. As one FinCEN analyst noted with respect to the use of cyber-currencies, "Bill Gates and the Medellin cartel don't provide enough cover for one another."

Nonetheless, FinCEN and law enforcement agencies must be proactive to head off the major advantage of new payment systems, namely that they could provide launderers easy transport for their funds to countries with lax financial control systems. According to the FATF's "1996-97 Report on Money Laundering Typologies,"

"Traditional law enforcement techniques and methods may become less effective or even obsolete. Law enforcement must begin to consider alternative approaches in addition to those in existence, to enhance their ability to prevent and detect money laundering as new payment system technologies gain world acceptance."⁸⁰

b. Technology to Help Law Enforcement.

Although technology aids money launderers, it also helps law enforcement and FinCEN. In 1995 the Office of Technology Assessment (OTA) published a report titled Information Technologies for the Control of Money Laundering. In it they concluded that while technology exists that might be able to sort through information to detect money laundering, the data and expertise do not exist to make much of the technology useful. "Knowledge-based systems on wire transfers alone cannot work because they require human expertise," according to the report. While, link analysis is feasible,⁸¹ the OTA believes that using computer screening to differentiate the estimated 250,000 transfers of illegal money, from among the several hundred million legal transfers each year, is almost

⁷⁹ "1996-1997 Report on Money Laundering Typologies." Financial Action Task Force on Money Laundering. www.oecd.org/fatf/fatfviii.htm#II. Pg. 24.

⁸⁰ "1996-1997 Report on Money Laundering Typologies." Financial Action Task Force on Money Laundering. www.oecd.org/fatf/fatfviii.htm#II. Pg. 30.

impossible.⁸² OTA concluded that a complete computer screening system for wire transfers is impractical as defining what a suspicious wire transfer looks like is only the first stumbling block. Other impediments include:⁸³

1. The rapid shifts between favored laundering techniques such as smuggling cash, converting monetary instruments, and using bank and non-bank wire transfers.
2. A wide range of "covers" for wire transactions, including shell corporations, front companies, and false invoicing.
3. Similarities between legitimate and illegitimate business.
4. Growing professionalism and expertise of white collar money launderers.
5. Lack of knowledge of non-drug related money laundering and of laundering associated with drug trafficking outside of South America.

Even if FinCEN could fully screen domestic wire transfers, the system would be greatly complicated by international and political considerations. Foreign governments and institutions are not capable of quickly justifying transactions. Thus no matter what the U.S. does, it is at the mercy of foreigners for this type of information.

Other possible technologies must be studied. As we detailed earlier, forcing criminals out of the financial sectors leads to increased shipping of bulk loads of cash. Unfortunately, "dirty" money does not look any different than licit money. The Departments of the Treasury and Justice are reportedly discussing ways to develop technological aids that would permit the detection of large volumes of currency being

⁸¹ U.S. Congress, Office of Technology Assessment, *Information Technologies for the Control of Money Laundering*, OTA-ITC-630 (Washington, DC: U.S. Government Printing Office, September 1995. Pg. 74).

⁸² Money Laundering Alert. Vol. 7, No. 3, December 1995. Pg. 5. and U.S. Congress, Office of Technology Assessment, *Information Technologies for the Control of Money Laundering*, OTA-ITC-630 (Washington, DC: U.S. Government Printing Office, September 1995).

⁸³ "OTA says a wire transfers defy money laundering controls." Money Laundering Alert. Vol. 7, No. 1. September 1997. Pg. 5.

smuggled into the country.⁸⁴ This technology would be of immense value to anti-money laundering efforts and should be pursued aggressively.

Less sophisticated technologies should not be ignored. The Geographic Targeting Order (GTO) belongs in an analysis of new technology as it has demonstrated great promise in displacing laundering organizations and their cash flows, and as a measurement tool. The first GTO was set up in 1996 between New York City and Colombia and has been renewed 6 times. It is credited with a dramatic decrease in drug proceeds being sent through remitters in New York City to Colombia. The increased vulnerability and risk created by displacement of the laundering organizations is supported by the fact that drug money cash seizures have increased 400% under the GTOs.⁸⁵ According to Warren, GTOs "...are most effective when resources and personnel are allotted in advance to detect the movement of cash by other means."⁸⁶ As the money laundering moves to other sectors it must be intercepted to achieve full success.

c. Who Seeks to Benefit Most?

Whether law enforcement and FinCEN or criminals benefit most from new technologies is determined by who adapts more swiftly to the new environment and incorporates new capabilities. History demonstrates that criminals will be quick to adapt; so too must law enforcement and FinCEN. The inability of government to respond quickly makes foresight all the more important. FinCEN and law enforcement can

⁸⁴ Marks, Alexander. "U.S. Firms Unwittingly Aid Drug Lords." The Christian Science Monitor. October 22, 1997. Pg. 1.

⁸⁵ "Treasury Cracks Down on Remittances to Dominican Republic." FinCEN Press Release. US Department of the Treasury, FinCEN. www.ustreas.gov/treasury/bureaus/fincen/drgto.html.

⁸⁶ Warren. Pg. 10.

benefit from new technologies and the changing environment if they focus their resources and continually revise their estimations of the future.

d. How can FinCEN Adjust and Capitalize on New Technology?

The key conclusion drawn from the implications and capabilities of future technology is that if FinCEN undertakes strategic analysis and planning they can help ward off potential problems—either by closing loopholes with respect to new payment systems or helping law enforcement exploit new technologies for their benefit. In each case it is important to anticipate shifts in the methods that money launderers will employ in response to changes in the environment.

FinCEN should dedicate resources to study how traditional regulation and law enforcement methods must be altered to handle new payment systems and how new technologies can be used to combat money laundering. FinCEN has an advantage in guiding and performing such a study as it is removed from traditional law enforcement. Special attention must be placed on not overlooking less sophisticated technologies such as the GTO. New technologies can be great assets to FinCEN and its clients if adequate attention is placed on anticipating their future implications. “Law enforcement and regulators must look forward to identify potential issues and new challenges now.”⁸⁷

⁸⁷ “1996-1997 Report on Money Laundering Typologies.” Financial Action Task Force on Money Laundering. www.oecd.org/fatf/fatfviii.htm#II. Pg. 19.

VI. Recommendations

To help combat money laundering and crime the Financial Crimes Enforcement Network (FinCEN) should help law enforcement agencies focus on displacing the launderers' organizations and methods of funds transfer. The best displacement methods are identified by understanding current money laundering and anticipating future changes. The following section outlines five recommendations to increase FinCEN's ability to aid law enforcement and combat money laundering.⁸⁸ The recommendations are organized according to the questions that prompted their development.

Is good information available on the costs and magnitudes of money laundering?

While estimates of the costs and magnitudes of money laundering exist, they are incomplete and unreliable. In the absence of good information, FinCEN is hampered in fulfilling its role as a provider of strategic intelligence and analysis. Thus, FinCEN must acquire better information on the costs and magnitudes of money laundering. FinCEN should:

- 1. Dedicate resources to collect, analyze, and distribute information on the costs and magnitudes of money laundering. FinCEN should endeavor to get information on non-drug related laundering and on individual costs of laundering activities.*

Estimates of the cost of money laundering may be determined by conducting comprehensive interviews with convicted individuals and law enforcement agents and by reviewing case files. However, information on the magnitudes of money laundering must come from additional sources. Therefore, FinCEN should:

⁸⁸ It is important to note that the recommendations do not necessarily indicate FinCEN's failings. On the contrary, where FinCEN's current activities and the recommendations overlap, FinCEN is well-positioned.

2. *Examine the use of Geographic Targeting Orders (GTOs), and other methods of displacement, to collect better information on the magnitudes of money laundering.*

Does increasing the price of laundering reduce crime?

Realizing that increasing the price of laundering services, alone, will not reduce crime, law enforcement should seek to displace the suppliers of laundering services to increase their vulnerability and risk. FinCEN can help law enforcement agencies successfully displace laundering organizations by doing the following. FinCEN should:

3. *Create and distribute to law enforcement agencies information on:*
 - a. *Suggested displacement methods for invalidating laundering organizations.*
 - b. *How displacement increases the vulnerability of criminals.*
 - c. *Why coordination among law enforcement is critical for detecting displacement.*
 - d. *Where displaced organizations and cash move and how they can be detected.*
4. *Develop methods of facilitating coordination among law enforcement agencies to be prepared when laundering organizations and their illicit proceeds are displaced.*

What is the impact of future technology on FinCEN's ability to help combat laundering?

Determining the impact of future technology on FinCEN's ability to support law enforcement is little more than guess-work. However, one obvious, yet extremely important recommendations is that FinCEN should:

5. *Dedicate resources to study:*
 - a. *New payment systems and how regulation and law enforcement must adapt; and*
 - b. *Potential new technologies for combating money laundering, including methods to detect the bulk shipment of cash. (FinCEN must be careful not to overlook less sophisticated technologies for combating money laundering.)*

VII. Provisions for Monitoring Outcomes

Determining whether FinCEN is able to carry out the recommendations in this Policy Analysis Exercise is straight forward. However, judging whether the recommendations are successful in helping FinCEN support law enforcement is another issue altogether. Measuring FinCEN's or law enforcement's success is a complicated matter whose discussion could fill a small library with well-intentioned articles, research papers, and texts. However, to determine whether the recommendations in this paper are serving their purpose there are a few informal methods that FinCEN should consider. These include direct feedback from law enforcement agencies and the relative demand for FinCEN's services and publications. Admittedly, these are rough proxies for success. Nonetheless, if the execution of this paper's recommendations help FinCEN aid law enforcement, FinCEN's services will become increasingly valuable to the law enforcement community.

VIII. Conclusion

The Financial Crimes Enforcement Network has a unique role and position in the fight against money laundering. Separated from the actual arrests and convictions of law enforcement, FinCEN strives to establish, oversee, and implement policies to prevent and detect money laundering. To do this FinCEN must constantly endeavor to better understand money laundering and the environment in which it takes place. This Policy Analysis Exercise increases FinCEN's understanding of money laundering and provides five recommendations for FinCEN to better help law enforcement. If FinCEN is able to act on these recommendations it will dramatically increase its ability to aid law enforcement and combat money laundering.

IX. Bibliography

- August, Oliver. "Governments Gunning for Money Launderers." The Times. London. October 1, 1996. Business.
- Bardacke, Ted. "Asia Warned of Money Laundering Dangers." Financial Times. February 28, 1997. Pg. 6.
- Blustein, Paul. "26-Nation Group Presses Fight Against Laundering of Money." Washington Post. June 29, 1996. Pg. D1.
- "Colombian Black Market Peso Exchange." FinCEN Advisory: Issues 9. US Department of the Treasury, FinCEN. November 1997.
- "December 1988 Statement on Prevention of Criminal Use of the Banking System for the Purposes of Money Laundering." Commonwealth Secretariat, London. Gilmore, W.C., International Efforts to Combat Money Laundering. Pg. 273-278.
- Doyle, Ed. Office of Research and Development. Interview. November 21, 1997.
- "FATF Report on Money Laundering," February 6, 1990; in Gilmore, W.C., International Efforts to Combat Money Laundering.
- "FinCEN Plan Promises Agents Monthly 'Targeting Packages.'" Money Laundering Alert. Vol. 9, No. 2. November 1997. Pg. 3.
- "FinCEN's Frequently Asked Questions: How has the Treasury Addressed the Problem?" US Department of the Treasury: FinCEN. **Error! Bookmark not defined.** /fincen/faqs.html/#problem.
- "FinCEN's Frequently Asked Questions: Who are FinCEN's Customers." US Department of the Treasury: FinCEN. **Error! Bookmark not defined.** /fincen/faqs.html/#problem.
- Gilles, Dave. Office of Management, FinCEN. Interviews and phone conversations. August through December 1998.
- "The Global Fight Against Money Laundering: Background." US Department of the Treasury: FinCEN. www.ustreas.gov/treasury/bureaus/fincen/border.htm.
- Gosling, Paul. The Independent (London) May 28, 1997.
- Graham, George. "The Cash Courier' Runs Out of Time." Financial Times. March 18, 1997. Pg. 4.
- Hart, Cordell. FinCEN Analyst. Interview. November 21, 1997.
- Hart, Cordell. "Money and 'Guanxi': Keys to Understanding Crime by Asians." US Department of the Treasury: FinCEN. Washington, DC. March 8, 1996.
- International Narcotics Control Strategy Report: March 1, 1988. U.S. Department of State. Washington, DC.
- Kleiner, Tom. FinCEN Analyst. Written comments on draft. March 26, 1998.
- Klingman, Charles. FinCEN Analyst. Interview. November 21, 1997.

"Laundering of Monetary Instruments." FDCH Congressional Testimony. July 24, 1997.

Marks, Alexander. "U.S. Firms Unwittingly Aid Drug Lords." The Christian Science Monitor. October 22, 1997. Pg. 1.

Money Laundering Alert. Vol. 7, No. 3, December 1995.

Morris, Stanley. FinCEN Director. Interview. November 21, 1997.

Nadelmann, E. "Unlaundering Dirty Money Abroad: US Foreign Policy and Financial Secrecy Jurisdictions." 18th Inter-American Law Review, 1986. Pg. 33, at 34.

Naylor, Robin. Hot Money and the Politics of Debt. New York: The Linden Press/Simon and Schuster. 1987.

"OTA says a wire transfers defy money laundering controls." Money Laundering Alert. Vol. 7, No. 1. September 1997. Pg. 5.

Passic, Greg. FinCEN Analyst. Interview. November 21, 1997.

Peaks, Sandra. FinCEN Personnel Director. Meetings, E-mail, and phone communication. August 1997-March, 1998.

Perambo, Germaine. FinCEN Analyst. Comments on draft. March 27, 1998.

"1996-1997 Report on Money Laundering Typologies." Financial Action Task Force on Money Laundering. [Http://www.oecd.org/fatf/fatfviii.htm#II](http://www.oecd.org/fatf/fatfviii.htm#II).

Rosenberg, Mike. FinCEN Analyst. Written comments on draft and conference call. March 26, 1998.

Royce, Knut. "The Money Trail." Newsday. Dec. 17, 1989. Pg. 10.

Ryder, Tom. FinCEN Analyst. Interview. November 21, 1997.

Sabbag, Robert. "Money Laundering: Hot Crime." Rolling Stone. August 21, 1997.

Sparrow, Malcolm. "Network Vulnerabilities and Strategic Intelligence in Law Enforcement." International Journal of Intelligence and Counterintelligence. Volume 5, No. 3.

Trapp, Roger. "Big Trouble With Dirty Money." The Independent. May 24, 1995. Pg. 27.

"Top Justice Deputy Voices Policy Priorities Under Reno." Money Laundering Alert. Vol. 5, No. 2; November, 1993. Pg. 4.

"Top NY Transmitter Rewarded Agents for Structuring, U.S. Says." Money Laundering Alert. Vol. 8, No. 11. August 1997. Pg. 5.

"Treasury Cracks Down on Remittances to Dominican Republic." FinCEN Press Release. US. Department of the Treasury, FinCEN. www.ustreas.gov/treasury.bureaus/fincen/drgto.html.

Trigaux, Robert. "The Dirty Business of Cleaning Cash." St. Petersburg Times. October 20, 1995.

U.S. Congress, Office of Technology Assessment, *Information Technologies for the Control of Money Laundering*, OTA-ITC-630 (Washington, DC: U.S. Government Printing Office, September 1995.)

Walter, Ingo. "The Economics of International Money Laundering." Papers on Latin America #31. September 1993.

Warren, Mary Lee, Deputy Assistant Attorney General. *Before the Sub-committee on Crime, Committee on the Judiciary, United States House of Representatives, Concerning Money Laundering and Drug Trafficking*. Federal Document Clearing House. July 24, 1997.

X. Works Consulted

"Anti-Money Laundering Regulations Extended to Card Clubs." Press Release. US Department of the Treasury, FinCEN. January 13, 1998.

Baity, William. Deputy Director (Now Acting Director) FinCEN. Initial meeting with FinCEN to set up the Policy Analysis Exercise. Aug 22, 1997.

Boland, Vincent. "Eastern Europe seeking to curb money laundering." The Financial Times. London. International; Pg. 2. February 15, 1997.

Cassara, John. Customs Agent. Interview. November 21, 1997.

"Non-Bank Financial Institutions: A Study of Five Sectors." Coopers & Lybrand for Financial Crimes Enforcement Network. February 28, 1997.

Orndorff, Mike. FinCEN Analyst. Interview. November 21, 1997.

"Prepared Testimony of Alvin C. James, Special Agent Internal Revenue Service." *Before the House Committee on Banking and Financial Services Subcommittee on General Oversight and Investigations*. Federal News Service. October 22, 1997.

Rohter, Larry. "New Bank Fraud Wrinkle in Antigua: Russians on the Internet." The New York Times. Section A; Pg. 4; Column 3. August 20, 1997.

"Russia, Mexico, Cayman Islands." US Department of the Treasury, FinCEN. **Error! Bookmark not defined..**